

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0019

Individual Income Tax

Calendar Years 1989, 1990, 1991, 1992, 1993, 1994, 1995, 1996, and 1997

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ISSUE(S)

I. **Individual Income Tax** – Change of basis – Income from S-corporation

Authority: IC 6-3-11, IRS Code Sec 1367

Taxpayer protests the disallowance of losses due to basis limitation in a Subchapter-S Corporation.

STATEMENT OF FACTS

Taxpayer is an attorney who was a late filer from 1989 through 1994. Taxpayer claimed that his CPA advised him not to file returns until he could file and pay them. Taxpayer, at time of audit had filed all delinquent returns with the IRS and the IDOR. The audit investigation found that the taxpayer filed all returns on November 22, 1995 and has not paid the tax due on any of them.

The file was generated as a result of taxpayer being a 33.3% shareholder in a subchapter S corporation and no returns reporting income or distributions had been filed. Taxpayer underwent some examination by the IRS that resulted in a hearing in Federal court. The exact charges or outcome of the Federal hearing are unknown to the hearing officer and were unknown to the auditor.

Taxpayer filed all returns for federal purposes as married filing separately. Indiana returns have been filed on the same filing status. Returns for 1995, 1996, and 1997 have been filed timely. A copy of the 1997 returns was included with the audit file along with a copy of extension. Taxpayer filed the 1997 on August 17, 1998. The return was adjusted by audit investigation.

Investigation revealed two returns were filed for 1994. Both returns were processed and billed. Taxpayer claims that the return dated 8/15/95 was filed in error. A return dated 11/14/95 is correct per the taxpayer. Investigation adjusted the 11/14/95 return to show proposed corrected income for Indiana tax purposes.

All adjustments made to the Indiana Individual Adjusted Gross Income Tax returns (Form IT-40) are made pursuant to IC 6-3-1-3.5 which includes all modifications to income for taxes deducted on the federal return and required to be added back for Indiana adjusted gross income tax purposes. The amounts were found from taxpayer's Schedule C and the Sub "S" Corporation's income tax returns.

The Federal adjusted gross income, as defined by IRC Section 62, is the starting base for Indiana adjusted gross income. Modifications are then made to arrive at Indiana adjusted gross income. IC 6-3-1-11 incorporates the Internal Revenue Code as a basis for Indiana adjusted gross income.

The investigation disallowed a long-term capital loss on stock since taxpayer had no basis in stock. Taxpayer had no investment in the corporation. Upon formation, taxpayer's name was used to acquire a floor plan agreement. Taxpayer handled the legal work of forming the corporation and legal work for the corporation involving sales of real estate with sectional and/or modular homes. It was the auditor's understanding that the floor plan agreement was secured by the inventory of the corporation. The Corporation at one time in 1990 was in default on the floor plan agreement. The exact date and length of default or facts are unknown to the hearing officer or the auditor.

The Corporation secured a loan to bring the floor plan out of default. Taxpayer claims to have been obligated by this loan. Auditor repeatedly requested proof of loan obligation from the taxpayer and his accountant. No proof was ever provided. The other loans to the corporation are from other shareholders or are obligations directly of the corporation. IRC Section 1367 dealing with the basis would include only shareholder direct loans to the corporation and any "at risk" obligations. Shareholder under investigation has provided no proof of any direct obligations of the corporation to shareholder or debt of corporation for which shareholder is personally liable. Investigation had therefore made adjustments to the shareholder's basis that have disallowed some losses claimed and adjusted other amounts of losses claimed by taxpayer.

Per IRC Sec. 1366(d)(1)(B), the losses and deductions of a shareholder of an S-corporation cannot exceed the sum of the adjusted basis of the shareholder's stock and the shareholder's adjusted basis of any indebtedness of the S-corporation to the shareholder.

DISCUSSION

Taxpayer has not provided documentation or proof that he was entitled to a basis deduction as a shareholder in an S-corporation.

FINDING

Taxpayer's protest is respectfully denied.